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In The
Supreme Court of the United States

October Term, 1985

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NANTAHALA POWER AND LIGHT COMPANY,
TAPOCO, INC., and ALUMINUM COMPANY
OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA, *ex rel.* UTILITIES
COMMISSION; LACY H. THORNBURG,
Attorney General, *et al.*,

Appellees.

— o —
On Appeal From The Supreme Court Of North Carolina

— o —
**MOTION FOR LEAVE TO FILE BRIEF
AS AMICUS CURIAE AND
BRIEF OF EDISON ELECTRIC INSTITUTE
AS AMICUS CURIAE IN SUPPORT OF
THE APPELLANTS**

— o —
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January 1986

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**MOTION FOR LEAVE TO FILE BRIEF
AS AMICUS CURIAE**

Pursuant to Rules 36 and 42 of the Rules of the United States Supreme Court, the Edison Electric Institute (EEI) respectfully moves for leave to file the attached brief as *amicus curiae*.¹ EEI previously filed a motion for leave to file a brief as *amicus curiae* in support of the Jurisdictional Statement in this appeal; by order issued December 9, 1985, that motion was granted.

¹While the appellants have consented to the filing of the attached brief as *amicus curiae*, the appellees have not. The appellants' letter providing consent has been filed with the Clerk of the Court.

SPECIAL INTEREST OF EDISON ELECTRIC INSTITUTE

EEI is the national association of investor-owned electric utility companies in the United States. EEI's members, in significant contrast to the Aluminum Company of America (Alcoa), obtain substantially all, if not all, their operating revenues and income from sales of electricity to consumers at rates regulated by state commissions (or local regulatory bodies) and the Federal Energy Regulatory Commission (FERC). At the retail level, EEI's members conduct their businesses in accordance with the broad duty of public utilities to serve the public.

Central issues in the decision below involve the relationship, consistent with federal preemption doctrine, between the separate powers of the FERC and the North Carolina Utilities Commission (NCUC) to regulate electric rates, and limitations imposed by the Commerce Clause of the United States Constitution on the power of the state of North Carolina to regulate the economic benefits of hydroelectric power generated within its borders. These issues are vitally important to electric utility companies and their customers, and the final opinion in the case may become a significant and far-reaching precedent.

Alcoa owns two companies which generate electric power within the state of North Carolina for sale in interstate commerce. These companies were parties to the rate proceedings before the NCUC which gave rise to this case. Unlike EEI's member companies, however, Alcoa is not primarily in the business of owning properties to generate electricity for sale to the public pursuant to federal and state rate regulation. Instead, Alcoa obtains practically all its revenues and income from the production and sale

of aluminum products. Since the production of aluminum requires large amounts of electric power, Alcoa is principally a consumer of electricity, not a producer.

Therefore, EEI is in a unique position to approach the issues from the perspective of electric utilities and their customers, which have a vital interest in the outcome. The attached brief as *amicus curiae* demonstrates that the questions arising in the case are substantial and may seriously affect the regulatory domain of electric utilities and their customers.

CONCLUSION

For the reasons set forth above and in the attached brief, EEI urges the Court to grant its motion for leave to file the attached brief as *amicus curiae*.

Respectfully submitted,

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QUESTIONS PRESENTED

Whether the preemption doctrine is violated by a rate decision of the North Carolina Utilities Commission allocating power supply costs in a manner different than those same costs were allocated by the Federal Energy Regulatory Commission when the FERC exercised its jurisdiction over federally regulated rate schedules, including the rate schedules under which the costs were incurred.

Whether the state commission's decision violates the Commerce Clause of the United States Constitution since it gives retail electric customers located in North Carolina a preference over an out-of-state customer with respect to the economic benefits of hydroelectric power generated within North Carolina.

PARTIES BELOW

The appellants in the North Carolina Supreme Court were Nantahala Power and Light Company, Tapoco, Inc., and Aluminum Company of America.

The appellees were State of North Carolina, *ex rel.* Utilities Commission; Lacy H. Thornburg, Attorney General; Public Staff of the North Carolina Utilities Commission; Henry J. Truett; Town of Bryson City; Swain County Board of County Commissioners; Cherokee County; Graham County; Jackson County; Town of Andrews; Town of Dillsboro; Town of Robbinsville; Town of Sylva; Tribal Council of the Eastern Band of Cherokee Indians; Muriel Maney; and Derol Crisp.

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OPINION BELOW

The opinion below is reproduced in the Appendix to the Jurisdictional Statement (A. 1a-138a) and reported at 313 N.C. 614 and 332 S.E.2d 397.

JURISDICTION

This Court has jurisdiction under 28 U.S.C. § 1257(2).

CONSTITUTIONAL AND STATUTORY PROVISIONS

The United States Constitution, Article VI, Clause 2: "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land. . . ."

The United States Constitution, Article I, Section 8, Clause 3: "The Congress shall have Power . . . [t]o regulate Commerce . . . among the several States. . . ."

The pertinent provisions of the Federal Power Act, 16 U.S.C. §§ 791a-828cc, are reprinted at A. 248a-261a.

INTEREST OF EDISON ELECTRIC INSTITUTE

Edison Electric Institute (EEI) is the national association of investor-owned electric utility companies in the United States. Its members serve approximately 96 per cent of all customers of the investor-owned segment of the electric utility industry and 73 percent of the nation's electricity users.

Today, many EEI members obtain a portion of their total supply of electrical capacity and energy (power)

available to sell to their retail customers through interstate, wholesale purchases from other utilities or from generating companies at rates regulated exclusively by the Federal Energy Regulatory Commission (FERC). For example, a typical EEI member will have wholesale purchase agreements with neighboring utilities. Additionally, many of EEI's members participate in interstate, multi-party power pools which include provisions for reciprocal wholesale sales and exchanges of power.

In these arrangements, ratemaking jurisdiction almost always rests first with the FERC and then with at least one state commission (or local agency) which establishes the retail rates that are necessary to pass through the costs of the wholesale supplies to the ultimate consumers. More than one state commission will be interested in the wholesale arrangement if there are several purchasers with service areas in different states. Therefore, many EEI member companies are exposed to a blend of regulation that includes FERC and at least one state commission and, quite possibly, may include two or more state commissions. This blend of regulation has created serious ratemaking conflicts.

The amount of electric power available for retail consumers that is supplied by arrangements involving wholesale purchases is enormous and will continue to increase. The costs associated with the largest of these wholesale arrangements, which sometimes have expected durations of approximately 30 years, may be measured in billions of dollars, and the planning involved to complete large projects consumes many years.

The legal principles involved in this case thus has great significance to EEI's members since the principles will affect the opportunity for recovery through state-regulated retail rates of costs established by the FERC.

STATEMENT OF THE CASE

EEI adopts the Statement of the Case presented in the Jurisdictional Statement.

SUMMARY OF ARGUMENT

In the opinion below, the North Carolina Supreme Court recognized correctly that the New Fontana Agreement and the 1971 Nantahala Tapoco Apportionment Agreement are rate schedules regulated exclusively by the FERC. Further, the lower court found that the North Carolina Utilities Commission (NCUC) is "preempted from directly or indirectly regulating the wholesale rate structure created" by the rate schedules or "inquiring into the reasonableness of those FERC-filed wholesale rate schedules when it acts in fixing Nantahala's retail rates." A. 75a.

The lower court ruled incorrectly, however, that the preemption doctrine (known as the Naragansett Doctrine when applied to utility rate regulation) only prevents the NCUC from automatically disallowing costs incurred pursuant to the FERC-regulated rate schedules. A. 81a-82a. Then the court found that although the NCUC reallocated cost responsibility between Nantahala Power and Light Company (Nantahala) and Tapoco, Inc. (Tapoco) for a hydroelectric power supply in a manner different than the FERC had done (or as was provided for directly in the rate schedules as they had been accepted for filing with the FERC),¹ the NCUC had not actually disallowed any costs.

¹In their Motion to Dismiss Appeal, the Appellees attempt to confuse the issue by drawing a distinction between an inter-
(Continued on following page)

The result of this decision is to shift cost responsibility from retail ratepayers served by Nantahala in North Carolina onto a customer served by Tapoco in Tennessee. Regardless of the lower court's refusal to recognize it as such, the reallocation of cost responsibility between Nantahala and Tapoco is the equivalent of a disallowance of costs to Nantahala which affects the sharing of costs between customers located in different states.

Furthermore, the lower court's opinion cannot be reconciled with leading precedent derived from the most analogous cases, the two *Northern States* cases, as well as *Office of Pub. Counsellor v. Indiana and Michigan Electric Co.* discussed in this brief. Contrary to the beneficial effects of those decisions on the stability of interstate, wholesale power arrangements, the court's opinion threatens the ability of electric utilities participating in wholesale power supply projects to recover their costs. If Tapoco's retail rates were regulated by Tennessee and if Tennessee made a decision similar to that made in this case by North Carolina, the utilities would be caught in the middle, as neither would be allowed to recover its costs.

The lower court's decision also violates this Court's decision in *New England Power Co. v. New Hampshire*, 455 U.S. 331 (1983) (*NEPCO*). As the lower court itself recognized:

NEPCO establishes that a state utilities commission may not grant its citizens a preferred right to the benefit of hydroelectric energy generated by a utility in that state to gain an economic advantage over the

(Continued from previous page)

state cost allocation plan which has been found just and reasonable by the FERC and one which has been merely accepted for filing by the FERC. Such a distinction is without significance under the preemption doctrine. *Montana-Dakota Utilities Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246, 251-252 (1951).

utility's out-of-state customers, and that the granting of such a preferred benefit, regardless of how it is effectuated, places a direct and substantial burden on interstate commerce in violation of the Commerce Clause.

A. 98a.

The court fails in its attempt to distinguish *NEPCO* on the grounds that in this case, the NCUC did not purport to prohibit the exportation of energy produced within North Carolina. *NEPCO* clearly recognized that the hydroelectric energy at issue in that case would not be contained within one state in a physical sense. *NEPCO* invalidates all "protectionist regulation" whether it takes the form of special rates (*i.e.*, "rates adjusted to reflect the . . . savings attributable to the low-cost hydroelectric generation", *id.* at 336), such as those adopted by the NCUC, or the form of an order overtly blocking the flow of interstate commerce at a state's borders.

ARGUMENT

I. THE DECISION BELOW VIOLATES THE PRE-EMPTION DOCTRINE.

The center of the controversy is the NCUC's choice of a method of cost allocation used to establish rates applicable to general retail service provided by Nantahala in the State of North Carolina and the effect of that choice on rates applicable to service of a customer in another state. Nantahala and Tapoco are wholly-owned subsidiaries of the Aluminum Company of America, and both are public utilities under the Federal Power Act (the Act), 16 U.S.C. § 824-824k (1985). Nantahala and Tapoco are parties to the "New Fontana Agreement" (the NFA) and the "1971 Nantahala-Tapoco Apportionment Agreement" (the 1971 Apportionment Agreement), which together con-

stitute rate schedules subject to the FERC's exclusive rate jurisdiction under Part II of the Act. The FERC-regulated rate schedules provide for Nantahala and Tapoco to deliver certain hydroelectric power to the Tennessee Valley Authority (TVA), and to receive in return certain entitlements to power, that are then apportioned between Nantahala and Tapoco.

Since Nantahala and Tapoco are separate corporations and have separate generating facilities, they have separate costs of owning and operating those facilities. Likewise, the power apportioned to each in return for the exchange with TVA is separately recorded as part of each company's own resources. Thus, as recorded on their separate books of accounts, Nantahala and Tapoco have their own costs of service. Furthermore, Nantahala's cost of service traditionally has been separately allocated in accordance with authorized methods of allocation among the different classes of service provided by the company in wholesale and retail rate cases before the FERC and the NCUC.

This approach was followed in a wholesale rate proceeding before the FERC which ran contemporaneously with the retail rate case before the NCUC that underlies this appeal. At issue in the hearing before the FERC were Nantahala's rate schedules for service to its wholesale customers, the NFA and 1971 Apportionment Agreement, all FERC-regulated rate schedules.² Although confronted with arguments advanced by parties representing the interests of Nantahala's wholesale and retail customers to disregard the separate corporate identities of Nantahala and Tapoco and thereby to view all entitlements flowing to Nantahala and Tapoco from TVA under the

²The town of Highlands, North Carolina contended in particular that the 1971 Apportionment Agreement should be "set aside." A. 288a.

NFA as if Nantahala and Tapoco were one and the same, the FERC specifically rejected such a "roll-in" method. *Nantahala Power and Light Co.*, Opinion No. 139, A. 291a, *aff'd*, *Nantahala Power and Light Co. v. FERC*, 727 F.2d 1342 (4th Cir. 1984) (hereinafter Opinion No. 139).

Moreover, the ultimate decision reached in Opinion No. 139 reflected a specific allocation of entitlements under the NFA to Nantahala. (The allocation used by the FERC differed from the allocation of entitlements prescribed by the 1971 Apportionment Agreement although the FERC stated that it was not modifying or reforming that agreement.) It is important to recognize that the FERC's decision in Opinion No. 139 endorsed the use of a different allocation of entitlements to Nantahala than would have been derived under the roll-in method sponsored by the parties representing Nantahala's wholesale and retail customers.

A. The Change In Allocation

Although both the NFA and the 1971 Apportionment Agreements are regulated as rate schedules by the FERC, the lower court did not require the NCUC in Nantahala's retail case to follow either the same allocation of entitlements that the FERC used in the wholesale case or the allocation prescribed by the 1971 Apportionment Agreement as it had been accepted for filing by the FERC in 1980. Instead, the lower court upheld the method employed by the NCUC in which Nantahala and Tapoco were first rolled together and a single, combined cost of service was derived. Then, the NCUC allocated cost responsibility to Nantahala and Tapoco on the basis of relative load responsibility. A. 55a. The NCUC's roll-in method was similar to that which the FERC had rejected despite the arguments of parties representing Nantahala's wholesale and retail customers.

In comparison with either the allocation of entitlements made in Opinion No. 139 or that prescribed in the 1971 Apportionment Agreement, the effect of the roll-in method is to produce a lower cost responsibility for Nantahala's general service customers, all of whom are located in North Carolina, and a higher cost responsibility for Tapoco, which serves only Alcoa's industrial load in the State of Tennessee.³

In its opinion, the North Carolina Supreme Court recognized that the NFA and the 1971 Apportionment Agreement fall within the "regulatory jurisdiction of the FERC under Part II of the Federal Power Act" (A. 72a) and that, "the North Carolina Utilities Commission is preempted from directly or indirectly regulating the wholesale rate structure created by the New Fontana and 1971 Apportionment Agreements or inquiring into the reasonableness of those FERC-filed wholesale rate schedules when it acts in fixing Nantahala's retail rates." A. 75a. To avoid the obvious problem with established principles of preemption as applied to utility ratemaking,⁴ the lower court

³As the lower court recognized, objection to the NCUC's decision to use the so-called roll-in method lies not only with the roll-in itself but with the related cost allocation method used to apportion the combined cost between Nantahala and Tapoco. A. 55a. For example, as asserted by the appellants, the worst aspect of the NCUC's cost allocation method is its use of an assumed level of entitlements that exceed actual entitlements under the NFA. Jurisdictional Statement at 10-11. The important and undisputed point for the purpose of this brief is that the NCUC's method did not follow either the FERC-regulated rate schedules or Opinion No. 139 in choosing a cost allocation method; therefore, cost responsibility was reallocated between Nantahala and Tapoco.

⁴As applied to utility ratemaking, preemption is frequently referred to as the "Naragansett Doctrine," after the often cited case of *Naragansett Electric Co. v. Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), cert. denied, 435 U.S. 972 (1978).

made a distinction between approving any effort on the part of the NCUC to "reform the contracts to alter the actual flow of return power [from TVA] thereunder," which it recognized would be patently unlawful, and merely permitting the NCUC to exercise discretion in "choosing between the competing jurisdictional cost allocation methodologies presented by the parties." A. 56a-57a.⁵

Despite the distinction drawn by the lower court, the roll-in method which it approved does produce a different allocation of entitlements to the TVA power for Nantahala and Tapoco than the allocation made by the FERC in Opinion No. 139 or as prescribed in the 1971 Apportionment Agreement. The NCUC implicitly recognized the actual nature of its decision when it stated, candidly, that there was no need to rewrite the NFA formally because the roll-in method was "an alternative solution available" which could be used to rectify the "inequities" in the entitlements created by the Agreements. A. 202a. The lower court's distinction amounts to a legal fiction conceived solely to attempt to avoid a collision with the preemption doctrine as set forth in its opinion.

B. The Decision's Incompatibility With Applicable Precedent

Furthermore, the North Carolina Supreme Court's analysis of the preemption cases brought to its attention is faulty and misleading in its emphasis. First, before analyzing the three most factually similar cases, the court concluded that there exists a preemption rule of general applicability to utility ratemaking which is consistent with

⁵Similarly, in an overly defensive statement, the North Carolina Supreme Court observed that "nothing contained in the Commission's order purports to change or modify a single word of the . . . agreements involved, or the actual flow of power thereunder." A. 76a (emphasis added).

the NCUC's decision. As stated by the court, the preemption rule "requiring state commissions to 'treat' costs based upon FERC-filed rates as reasonably incurred operating expenses, thus preventing the automatic disallowance of these costs, has not been held to preclude state authority to determine whether these costs should be automatically passed through to retail consumers in the form of higher rates." A. 81a-82a.

This statement of a preemption rule strains the meaning of the cases from which it is derived.⁶ More importantly, the court failed to recognize that those cases involve factual situations significantly dissimilar to the case below. None of those cases called into question a decision on the part of a state commission to allocate entitlements to interstate power supply and related costs between two utilities in a manner different from a plan of allocation found just and reasonable by the FERC pursuant to its authority under the Act.⁷

Second, after shaping a narrow preemption rule on the basis of cases within a limited factual range, the court incorrectly found that the cases "upon which Nantahala and Alcoa place principal reliance . . . do not lead to a different conclusion." A. 84a-85a. Its attempt to distinguish the two *Northern States* cases, *Northern States Power Co. v. Minnesota Pub. Util. Comm'n*, 344 N.W.2d 374 (Minn.), *cert. denied* 104 S.Ct. 3546 (1984) and *North-*

⁶The cases, beginning with *Naragansett Electric Co. v. Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978), are discussed by the lower court at A. 81a-84a.

⁷Indeed, two of the cases involve research and development expenditures rather than costs attributable to power generation. *Pub. Serv. Co. of Colorado v. Pub. Util. Comm'n of Colorado*, 644 P.2d 933 (Colo. 1982), and *Washington Gas Light Co. v. Pub. Serv. Comm'n of the District of Columbia*, 452 A.2d 375 (D.C. App. 1982), *cert. denied*, 462 U.S. 1107 (1983).

ern States Power Co. v. Hagen, 314 N.W.2d 32 (N.D. 1981), is contrivance rather than correct reasoning. In both *Northern States* cases, state commissions failed to pass through in the form of higher retail rates the costs of an abandoned power generation project that had been allocated pursuant to a FERC-regulated rate schedule to utilities subject to their retail rate jurisdictions. The supreme courts reversed the orders of their respective state commissions, as even the lower court itself stated, "on the ground that the reasonableness of a . . . wholesale rate filed and approved by FERC cannot be relitigated in a retail rate proceeding before a state utilities commission." A. 85a.

The lower court implicitly recognized that the *Northern States* cases, involving a cost allocation plan established by the FERC for a power generation project, are directly on point. Plainly in an effort to protect retail ratepayers within North Carolina from higher rates at the expense of an out-of-state ratepayer, however, the court contrived the distinction that such cases prohibit only a direct disallowance of costs allocated according to a FERC-regulated rate schedule, whereas the NCUC "did not disallow any of the system costs incurred by both Nantahala and Tapoco under the NFA and 1971 Apportionment Agreement in determining the aggregate rate base and operating expenses of the rolled-in system." A. 86a. Elaborating, the court stated that, "all costs attributable to Nantahala and Tapoco were *recognized and allowed* by the roll-in; the difference between 'book' costs and 'reasonable' costs resulting from the Commission's discretionary determination that only a certain percentage of Nantahala's book costs were incurred in serving the combined system's intrastate retail customers." A. 86a.

Irrespective of the lower court's view, it is inescapable from the point of view of Nantahala that some of its "book" costs of power generation allocated to it pursuant to the FERC-regulated rate schedules were disallowed by the NCUC.⁸ Thus, as a result of the so-called roll-in method, Nantahala's retail customers, all of whom are located in North Carolina, will not pay for Nantahala's production and purchased power costs in the same proportion they would have if the NCUC had respected the FERC-regulated rate schedules; and Alcoa's plant in Tennessee will incur responsibility for the difference.

If Tennessee's state commission were to regulate Tapoco's retail rates⁹ and made a similar "discretionary determination that only a certain percentage of [Tapoco's] book costs were incurred in serving the combined system's intrastate retail customers," the two utilities and their parent would be caught in the middle, as neither utility

⁸Taking the lead from the lower court's opinion, the "Appellees" also contend that this "is not a case where the NCUC disallowed FERC-approved wholesale power costs on the grounds that such costs were unreasonable" but is instead a case in which the NCUC "... allowed all relevant costs in the single-system 'pot' and allocated the proper portion of such rolled-in costs, using traditionally accepted allocation methods, to the Nantahala retail load." Appellees' Motion to Dismiss Appeal and Motion to Affirm Judgment of the North Carolina Supreme Court (Appellees Brief) at 12-13. Appellees argument repeats the court's own empty reasoning without bolstering it. The NCUC's decision results in a disallowance of costs which Nantahala would have incurred under either the FERC-regulated rate schedules as filed or as they were used by the FERC in Opinion No. 139. Moreover, while the NCUC may have used "traditionally accepted" methods of allocation following the roll-in of Nantahala and Tapoco, it is not traditional or commonplace in utility ratemaking for two separate corporations to be rolled together as if they are one.

⁹In a more typical situation than the specific facts of this case present, Tapoco might have a mix of customers similar to Nantahala's; in such a case, it is likely that Tennessee would assume the responsibility of regulating Tapoco's retail rates.

would be allowed to recover its cost of service. The result of this cost shifting could be disastrous if Tapoco and Nantahala were owned by a parent company which derived substantially all its revenues from their retail rates.

The FERC lacks the power to order state commissions to permit recovery through retail rates of regulated wholesale rates. Therefore, absent protection by the courts through enforcement of a sound preemption rule, the ability of Nantahala and Tapoco to render service to their customers would be impaired. EEI notes with concern the State of Tennessee's belief that the North Carolina Supreme Court's decision permits the NCUC to "wholly disregard FERC's determination and decide for itself that electricity arrangements between states are unreasonable," and that the NCUC may "then refuse to permit local utilities to recover the costs they incur under FERC's wholesale rate schedules." Tennessee Brief at 8. If other states read the lower court's decision the same way, and if the decision is upheld as written, wholesale power supply arrangements throughout the nation could be undermined.

The lower court relied on the fiction that all production costs attributed to a combined Nantahala-Tapoco system "were *recognized and allowed*" to avoid the problem of cost shifting caused by the NCUC's order. That reliance is dependent in large part on the validity of the lower court's determination to "pierce the corporate veil" and treat the two affiliated companies as one. However, with regard to a case involving the pass through of power generation costs between two affiliated utilities pursuant to a FERC-regulated rate schedule, the Supreme Court of New Hampshire recently found that the issue of piercing the corporate veil is "within the FERC's domain of

fixing the wholesale rate between these parties.” *Appeal of Sinclair Machine Products, Inc.* (N.H. Pub. Util. Comm’n), 498 A.2d 696, 706 ((1985)). That court also found that the “modern trend”¹⁰ in applying the preemption doctrine to state regulation of retail electric rates is to preempt the state from considering matters actually determined, whether expressly or impliedly, by the FERC. *Id.* at 703. As discussed, the FERC, in deciding not to adopt roll-in, expressly rejected the argument that it should pierce the corporate veil between Nantahala and Tapoco.¹¹

The lower court’s treatment of *Office of Pub. Counselor v. Indiana and Michigan Electric Co.*, 416 N.E.2d 161 (Ind. App. 1981), also is unconvincing. Here again, the case involves an allocation of power generation costs pursuant to a FERC-regulated rate schedule in the context of a retail rate proceeding before the appropriate state commission. Moreover, the device used by the state

¹⁰The court’s reference to a “modern trend” reflects some decisions in lower courts and various regulatory agencies which may be perceived as creating an exception to the rule requiring a state commission to treat FERC-regulated rates as reasonable expenses. *Id.* at 703. See, e.g., *Pike County Light and Power Co. v. Pennsylvania Pub. Util. Comm’n*, 465 A.2d 735 (Pa. Commw. Ct. 1983). The exception, if valid, would permit a state commission to consider the prudence of a utility’s decision to make a purchase under FERC-regulated rates in light of other power supply options available to the utility. The decision below does not expressly or impliedly turn on an exception, if any, of this type because the prudence of Nantahala’s power supply arrangements with TVA in light of other possible arrangements, if any, is not questioned.

¹¹*Accord United Gas Corp. v. Mississippi Pub. Serv. Comm’n*, 240 Miss. 405, 127 So.2d 404 (1961), wherein the Supreme Court of Mississippi rejected the view of the state’s retail ratemaking commission that, because the interstate and intrastate companies were affiliated, the commission could disregard the FPC [predecessor to FERC] rates. (“There is nothing to suggest that the FPC will not closely scrutinize this relationship, for the statutory purpose of protecting the public and consumers from exploitation.”)

commission to alter the level of costs allocated pursuant to the FERC-regulated rate schedule was a roll-in of the generation resources of two separate corporate identities. The Indiana Court of Appeals struck down the state commission’s roll-in, in the words of the court below, because it constituted “an impermissible collateral attack on the authority of the FERC.” A. 87a.¹² Once more, however, the lower court offered the faulty explanation that the NCUC’s roll-in was different because it did not result in a disallowance of Nantahala and Tapoco’s combined generation costs. Then, it stated that, “Moreover, it is obvious that the ‘roll-in’ attempted by the Indiana Commission entailed a far more direct intrusion into FERC’s regulatory domain. . . .” A. 88a.

The lower court’s statement carries an implied admission that the NCUC has intruded on the FERC’s authority. The court’s distinction between a “far more direct intrusion” and presumably an intrusion of ordinary dimensions should not be accepted. *Federal Power Comm’n v. Southern California Edison Co.*, 376 U.S. 205, 215-216 (1964). (“Congress meant to draw a bright line easily ascertained, between state and federal jurisdiction making unnecessary . . . case-by-case analysis.”) See also, *Northern Natural Gas Co. v. State Corp. Comm’n. of Kansas*, 372 U.S. 84, 91-93 (1963). Regardless of the lower court’s subjective view of the degree of severity, federal preemption precludes that intrusion.

Lastly, it must be pointed out that the North Carolina Supreme Court concluded its discussion of preemption with a sweeping statement of instances in which, the court said, a state commission can disallow costs incurred under FERC-regulated rate schedules:

¹²*Accord, Sinclair Machine Products*, 498 A.2d 696 (1985).

[S]tate commissions have been held to expressly retain, under the "filed rate" doctrine, the authority to decline to automatically reflect operating expenses incurred under FERC-regulated rate schedules or contracts in the structure of intrastate retail rates where, for example, the state commission determines (1) that increases in FERC-approved charges in one area of the utility's operations were not [sic] offset by economies in other areas . . . ; (2) that certain FERC-regulated costs were not, either in whole or in part, primarily incurred for the benefit of retail rate payers, but rather for the benefit of the utility's investors . . . ; (3) that in light of available alternatives, certain FERC-approved expenses charged by a parent to the local utility were not reasonably attributable to the costs of serving local rate payers . . . ; and (4) that certain FERC-regulated payments between parent and subsidiary were not required for service to the local rate payers . . . (*citations omitted*)

A. 88a.

While these conclusions, by and large, are based on an incorrect reading of the minority-view cases cited by the lower court, they cannot go unchallenged because this broad language is an invitation to advocates of increased state commission discretion to disallow costs incurred under FERC-regulated rate schedules. Unless this Court ceases this statement, it will come back again and again to hobble the FERC in the performance of its statutory duties.

In summary, in finding that the NCUC's order did not violate the preemption doctrine, the decision of the North Carolina Supreme Court is inconsistent with key decisions of the supreme courts of the States of Minnesota and North Dakota and of the State of Indiana's court of appeals in cases far more similar to the case below than any other preemption cases decided by courts to date. If allowed to stand, the decision could imperil the electric

utility industry's reliance on FERC-regulated power supply contracts to meet large portions of the nation's demand for electrical power.

II. THE MOTIONS TO DISMISS THE APPEAL DO NOT CONTAIN ANY ARGUMENTS ON THE PREEMPTION ISSUE THAT ARE MERITORIOUS.

Various arguments not previously addressed in this brief were presented in Appellees Brief and in the "Brief for The Town of Highlands, North Carolina, as *Amicus Curiae* Supporting Motion to Dismiss or Affirm" (Highlands Brief), concerning the substance of the decision below. EEI contends that these arguments are devoid of merit.

A. The Faulty Argument That The NCUC's Decision It Not Prohibited By The Preemption Doctrine Since Opinion No. 139 Did Not Allocate Costs Under The NFA And The 1971 Apportionment Agreement

The most pervasive argument found in Appellees Brief and Highlands Brief is that, in effect, the lower court's opinion is compatible with the preemption doctrine since Opinion No. 139 merely determined just and reasonable wholesale rates for Nantahala's wholesale customers without establishing a just and reasonable allocation of entitlements and related costs to Nantahala and Tapoco under the NFA and the 1971 Apportionment Agreement. For example, Appellees contend that: (1) since the ultimate issue resolved in Opinion No. 139 was the justness and reasonableness of Nantahala's wholesale rate increase, "FERC did not review the two Agreements for their *independent* 'justness and reasonableness'" (emphasis added); (2) "FERC viewed the fairness of the Agreements only under § 205 of the Act, for the *limited* purpose of deter-

mining the reasonableness of Nantahala's proposed wholesale rates" (*Id.* at 18) (emphasis added); (3) "FERC did not allocate power and costs with respect to the NFA and the 1971 Apportionment Agreement"; and (4) "the NCUC did not interfere with a FERC § 206 allocation of costs among states or among utilities." Appellees Brief at 18, 20, 22.¹³

Similarly, Highlands contends that: (1) "FERC Opinion No. 139 did not allocate costs between affiliated utilities or between states"; (2) "FERC did not approve or modify the NFA or the 1971 Apportionment Agreement to determine a just and reasonable allocation of costs between North Carolina and Tennessee or between Tapoco and Nantahala"; and (3) "FERC emphasized that in Opinion No. 139 it acted only in the context of establishing just and reasonable rates for wholesale customers and was not purporting to allocate interstate power flows or costs." Highlands Brief at 3, 5, 6.

Although the FERC did not reform either the NFA or the 1971 Apportionment Agreement in Opinion No. 139, it is unreasonable to assume that the FERC did not decide Opinion No. 139 on the basis of a just and reasonable

¹³Commingled with these assertions is a bewildering attempt to describe Opinion No. 139 as an exercise of the FERC's jurisdiction under Section 205 of the Act but not of its jurisdiction under Section 206. Appellees Brief at 14, 15, 16, fn. 19, and 18. See also Highlands Brief at 7. While there is a valid distinction between Section 205 and Section 206 for some purposes, such as resolving burden of proof issues or determining whether the FERC may order refunds, the distinction is irrelevant in this appeal. As noted in the quotation from Opinion No. 139-A cited in Highlands Brief at 7, the FERC specifically stated that Nantahala's "proposed rate increase was set for hearing under both Sections 205 and 206 of the Federal Power Act." In fact, the FERC has stated repeatedly that, "Every proceeding under Section 205 of the Federal Power Act involves Section 206 as well." *Pacific Gas and Electric Co.*, 10 F.E.R.C. ¶ 61,304 (1980) at 61,609. See, e.g., *Central Maine Power Co.*, 8 F.E.R.C. ¶ 61,322 (1979) at 61,929.

allocation of entitlements of TVA power and related costs to Nantahala. To the contrary, it would seem impossible for the FERC rationally to have reached a just and reasonable rate level for Nantahala's wholesale business without first having determined a just and reasonable allocation of entitlements and costs of a major source of wholesale power which Nantahala shared with Tapoco as a result of a joint exchange of power with TVA made pursuant to FERC-regulated rate schedules. A wholesale rate could not be deemed just and reasonable by the FERC unless the FERC had arrived at a reasonable determination of the power supply costs to be recovered by the rate.¹⁴

Not surprisingly therefore, the FERC stated in Opinion No. 139-A that it was concerned that "each party [Nantahala and Tapoco] receive its proper entitlement." A. 309a.¹⁵ Moreover, the FERC's explanation of why it "did not choose to reform the 1971 Apportionment Agreement" is inconsistent with the theory that the FERC did not make an implicit determination on the justness and reasonableness of the NFA and the 1971 Apportionment Agreement. Although it wanted to ensure that Nantahala

¹⁴As the lower court observed,

The unique problem posed by this case lies in the fact that Nantahala's available power supply was contractually reshaped by the quantity and design of the entitlements retained by TVA under the NFA and allocated to Nantahala under the 1971 Apportionment Agreement.

A. 55a.

¹⁵In the "Brief for the United States and the Federal Energy Regulatory Commission as Amici Curiae," the FERC states that Opinion No. 139 involved "determinations . . . concerning how 'entitlements' to certain power, received in return for other power, should be divided between two utilities, serving neighboring states." Brief at 6. This position is neither "inexplicable" as the Appellees contend (Brief at 16, fn. 19), nor "erroneous" as Highlands contends (Brief at 6).

would receive a "proper entitlement," the FERC simply was "not concerned with the mechanics of how entitlements of energy from TVA are allocated to each party." A. 309a. In other words, the FERC did not think it was necessary to reform the 1971 Apportionment Agreement in order to establish a just and reasonable level of entitlements.

Thus, despite the FERC's statement that it did not reform the 1971 Apportionment Agreement, EEI believes that Opinion No. 139 includes a determination by the FERC of a just and reasonable allocation of power supply entitlements and related costs pursuant to FERC-regulated rate schedules. Therefore, EEI sees a conflict between Opinion No. 139 and the NCUC's decision underlying this appeal, and that conflict represents a threat to the preemption doctrine if the opinion below is allowed to stand.

Further, under a corollary or overlapping rule known as the "filed rate" doctrine, if the FERC has accepted certain rate schedules for filing pursuant to the Act but does not alter or modify them, then the provisions of those rate schedules, as accepted for filing, govern any wholesale transaction taking place pursuant to them, and no state commission may order a change in the provisions. *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246, 251-52 (1951). Accordingly, a rate schedule accepted for filing with the FERC, although neither approved nor modified, should be given the same weight by a state commission in a retail rate case as a rate schedule that has been modified or reformed by the FERC following an evidentiary hearing. In the context of this case then, resolution of the preemption issue should be the same irrespective of whether the NFA and the 1971 Apportionment Agreement were found to be just and

reasonable with certain modifications or left untouched by the FERC in Opinion No. 139.¹⁶

B. The Faulty Argument That The NCUC's Decision Is A Proper Exercise Of Its Authority To Adopt Its Own Ratemaking Policies

Appellees and Highlands contend that the NCUC's decision represents the permissible exercise of the NCUC's jurisdiction to regulate retail rates under standards differing from the standards used by the FERC to regulate wholesale rates. See Appellees Brief at 15-16 ("It has been repeatedly recognized that Federal and State regulatory commissions can adopt different ratemaking policies.") and Highlands Brief at 8-10 ("There is no question that states in setting rates to retail customers and the FERC in setting rates to wholesale customers may use different ratemaking methodologies."). This argument is superficial and misplaced.

A typical investor-owned electric utility, such as Nantahala, has wholesale and retail customers. Under our dual regulatory system, the FERC is charged with the duty of ensuring that Nantahala's wholesale rates are reasonable, and the NCUC is charged with the duty of ensuring that Nantahala's retail rates are reasonable. It is recognized that to serve this goal, each commission has authority to establish its own ratemaking standards. For example, the FERC may decide that Nantahala's wholesale rates should be set to give it an opportunity to earn a rate of return allowance of 14 percent, while the NCUC may

¹⁶Indeed, as observed previously, the North Carolina Supreme Court itself stated emphatically that the NCUC is preempted from "... inquiring into the reasonableness of those FERC-filed wholesale rate schedules when it acts in fixing Nantahala's retail rates." A. 75a (emphasis added).

find that Nantahala's retail rates should reflect a rate of return allowance of 16 percent.

Everything else equal, this probably would mean that Nantahala's retail rates would be higher than its wholesale rates—a result compatible with dual regulation and not violative of the preemption doctrine. Nantahala is not harmed by the difference; and the stability of the interstate wholesale transactions underlying the FERC's jurisdiction is not threatened.

The NCUC's decision, insofar as it involves a simultaneous allocation of wholesale power supply and related costs of such power among different companies pursuant to FERC-regulated rate schedules (irrespective of whether the FERC has merely accepted them as filed or modified or approved them), presents a different challenge to maintaining order in a dual regulatory system. The long-standing system of utility regulation will fail if the NCUC can disregard an allocation plan used by the FERC. See discussion earlier at 2, 12-13 and Tennessee Brief at 8.

As part of their argument that the NCUC's decision represents a proper exercise of a state commission's authority to adopt its own ratemaking policies, Appellees (Brief at 15) and Highlands (Brief at 9) rely on dictum in Opinion No. 139-A indicating a lack of concern on the FERC's part despite its knowledge that the NCUC had reached "a different conclusion concerning roll-in costing." A. 305a. Similarly, Highlands also argues that there is no basis "for concluding that the FERC intended to require the NCUC to use for retail ratemaking purposes the same assumed entitlements that it used for wholesale rates." Brief at 8. These arguments are unpersuasive.

Opinion No. 139-A is an order on rehearing in which the FERC's immediate concern was explaining why it

had not adopted a roll-in method despite strenuous arguments that it should have.¹⁷ Furthermore, the FERC typically does not use rate orders to instruct state commissions on the preemption doctrine. Therefore, it is unreasonable to assume that Opinion No. 139-A supports the NCUC's decision simply because the FERC did not express an objection to it in Opinion No. 139-A. Moreover, application of the preemption doctrine is not contingent upon an expression of intent by the FERC "to require" a state commission to follow the FERC's order. The FERC has no authority to require a state to comply with preemption, nor does it typically get involved with preemption issues of the type presented by this appeal as a regular part of issuing its ratemaking decisions.

Left standing as is, the opinion below threatens the ability of utilities purchasing bulk power supplies under rates set by the FERC to obtain or maintain adequate and stable retail rates. This situation will be particularly acute when ratemaking jurisdiction is not only divided between the FERC and a single state commission but instead, among the FERC and more than one state commission. See Tennessee Brief generally. Furthermore, the decision could jeopardize attempts to plan and finance interstate power projects and power pooling agreements that will be needed in the future to meet expected load growth. Accordingly, the lower court's decision should not be affirmed on the erroneous ground that it involves nothing more than affirming the authority of a state commission to adopt its own ratemaking rules and policies.

¹⁷The NCUC's decision had been lodged with the FERC as part of an argument to induce the FERC to change its decision on roll-in, not as part of a brief on the preemption doctrine.

III THE DECISION BELOW VIOLATES THE PROHIBITION AGAINST UNDUE INTERFERENCE WITH INTERSTATE COMMERCE.

Unlike precedent on the preemption issue, which so far has been crafted by lower federal and state courts, precedent on the relationship of the Commerce Clause, U.S. Const., art. I, § 8, cl. 3 (Commerce Clause), to the power of states to regulate the economic benefits of hydroelectric power flowing in interstate commerce is "well-settled," *Middle South Energy, Inc. v. Arkansas Pub. Serv. Comm'n*, 772 F.2d 404 (8th Cir. 1985), *petition for cert. filed*, 54 U.S.L.W. 3393, November 21, 1985 (No. 85-895), A. 330a, because this Court has spoken. *New England Power Co. v. New Hampshire*, 455 U.S. 331, 334 n.10 (1983) (deferring resolution of preemption issue in favor of resolving Commerce Clause issue). Therefore, unlike its analysis of the preemption issue, in which the lower court confused the most significant precedent with precedent derived from similar but less meaningful circumstances, the lower court's analysis of the NCUC's decision in light of the Commerce Clause implicitly recognizes that one case, *New England Power Co. (NEPCO)*, controls.

We agree with the companies' contention that *NEPCO* establishes that a state utilities commission may not grant its citizens a preferred right to the benefit of hydroelectric energy generated by a utility in that state solely to gain an economic advantage over the utility's out-of-state customers, and that the granting of such a preferred benefit, regardless of how it is effectuated, places a direct and substantial burden on interstate commerce in violation of the Commerce Clause.

A. 98a.

In not agreeing with the assertion "that the rule announced in *NEPCO* invalidates the action of the Commission in this case" (A. 98a), however, the lower court resorted to the same, superficial form of distinction it drew with respect to the *Northern States* cases and *Office of Public Counsellor v. Indiana and Michigan Electric Co.* The court noted:

However, unlike the action of the New Hampshire commission, the roll-in performed by the Commission in this case does not *purport* to prohibit the exportation of energy produced within North Carolina, nor does it divert the flow of Tapoco's power to Nantahala. More importantly, the roll-in methodology used by the Commission does not exclusively reserve to the citizens of North Carolina the entire economic benefit of the unified system's low-cost in state hydroelectric generation.

A. 100a-101a (emphasis added).

The court's reliance on its interpretation of the New Hampshire commission's order as purporting to prohibit the exportation of hydroelectric power produced within New Hampshire is insufficient. In *NEPCO*, this Court decided the Commerce Clause issue knowing that, "[t]he Commission did not, however, order New England Power to sever its connections with the Power Pool." *NEPCO* at 336. Moreover, *NEPCO* is clearly premised on recognition that:

So long as the electricity produced at New England Power's hydroelectric plants continues to flow through the Pool's regional transmission network, it will be impossible to contain that electricity within the State of New Hampshire in any physical sense. Although the precise contours of the Commission's order are unclear, it appears to require that New England Power sell electricity to New Hampshire utilities in an amount equal to the output of its in-state hydroelectric facil-

ities, at special rates adjusted to reflect the entire savings attributable to the low-cost hydroelectric generation.

Id. at 336 (footnote omitted).

Thus, although the order of the New Hampshire Commission was cast in terms of prohibiting the export of hydroelectric power outside the state, *NEPCO* invalidates "protectionist regulation" (*Id.* at 339) taking the form of special rates as well as an order overtly blocking the flow of interstate commerce at a state's borders.

Indeed, finding *NEPCO* dispositive, the United States Court of Appeals for the Eighth Circuit recently affirmed the judgment of the district court enjoining the Arkansas Public Service Commission (APSC) from even continuing a show cause proceeding, aimed at protecting the citizens of Arkansas from a wholesale rate increase,¹⁸ although the state's attorney general argued that there was no significant burden on interstate commerce because "the APSC has only issued a show cause order, and not actually voided the contracts in issue." *Middle South Energy*, A. 332a. Furthermore, while the APSC sought to cancel the agreements at issue "because they have not received the necessary state regulatory approval", the court saw that the APSC's motivation was economic protection of its citizens at the expense of citizens in other states. *Middle South Energy*, A. 341a ("Given free rein, the APSC would shift this burden [wholesale rate increase pursuant to the Act] to the citizens of Mississippi and Louisiana, citizens who are powerless to directly influence Arkansas' internal affairs.") In this case, it is also "abundantly plain" (A. 340a) that the NCUC's motivation is to protect Nanta-

¹⁸The wholesale rate increase reflected the FERC's allocation among several states of the costs of a new generating unit.

hala's general service customers by shifting the burden of a rate increase to another state.

The argument that *NEPCO* is not violated because the NCUC's order does not "exclusively reserve to the citizens of North Carolina the entire economic benefit of the unified system's low-cost in-state hydroelectric generation" is inadequate.¹⁹ Obviously, a great deal of the economic benefit of North Carolina's in-state hydroelectric generation is reallocated to Nantahala. Moreover, the NCUC order gives North Carolina customers the potential benefit of an ever-increasing preference to the less expensive hydroelectric power generated in North Carolina (and Tennessee). See Jurisdictional Statement at 9-12.

The NCUC stated that the cost allocation method chosen by it assumed that Nantahala's public load had a "first call on the total electric energy output of the combined Nantahala-Tapoco system." A. 102a. The court contends, however, that a complete reading of the NCUC's order shows that the NCUC's "initial characterization" of its method as creating a "first call" was in error. A. 103a. Accepting the court's interpretation of the NCUC's order for the sake of argument, the fact remains that, for the reason explained in the Jurisdictional Statement,²⁰ the order has the effect of giving Nantahala's customers a first call on the cheaper hydroelectric power. In turn, this requires Tapoco to take more expensive power to serve Alcoa's plant in Tennessee.

¹⁹Appellees repeat the lower court's faulty reasoning but do not point out any merit in it. Appellees Brief at 26-27.

²⁰As explained therein, the operative factor is the use of assumed entitlements that exceed actual entitlements under the NFA.

The order is, therefore, an act of simple economic protectionism that is *per se* unlawful under *NEPCO*. The lower court's attempt to characterize the NCUC's order as "even-handed" regulation of the type upheld in *Arkansas Electric Cooperative Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 375 (1983), also is inadequate. There the choice confronting this Court was between regulation of the cooperative's wholesale rates by the APSC or no regulation in view of the Federal Power Commission's (now the FERC) earlier determination that it lacked jurisdiction over such rates under the Act. The Court's affirmation of the APSC's assertion of jurisdiction by the APSC over otherwise unregulated rates, notwithstanding that the cooperative was tied into the interstate grid, on the basis of a balancing test is plainly different. There was not a hint of discriminatory, economic protection at work in that case.

Furthermore, the bare facts that "the setting of retail electric rates for Nantahala's customers is clearly a legitimate North Carolina interest with a significant impact in this state" and that the price charged to Nantahala's retail customers may only have a "*de minimis*" effect on the "interstate 'grid'" (A. 105a), do not entitle North Carolina to the more lenient balancing test applied in *Arkansas Electric Cooperative* for facially neutral economic regulation. In *NEPCO*, this Court could have applied a similar rationale to uphold the New Hampshire commission's order since New Hampshire clearly has an interest in keeping electric rates within its borders as low as lawfully possible. Thus, the lower court's effort to distinguish *NEPCO* fails.

CONCLUSION

The Court should overrule the opinion below.

Respectfully submitted,

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